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Nos. 83-908 and 83-909

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

HARRY S. STONEHILL,

Petitioner

v.

UNITED STATES OF AMERICA

ROBERT P. BROOKS,

Petitioner

v.

UNITED STATES OF AMERICA

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY MEMORANDUM IN SUPPORT OF PETITIONS FOR CERTIORARI

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REPLY MEMORANDUM IN SUPPORT OF PETITIONS FOR CERTIORARI

The Government's treatment of this case ignores the foundation fact that the judgment below imposes an eighteen million dollar tax liability upon Petitioners based solely upon evidence which was not in the record. The issue is believed to be one of first impression. The bases of the judgment in law and fact have been totally undermined by conceded error, judicial recantations and conflicts with decisions of this Court and other circuits.

The Memorandum in Opposition [MO] filed presents an essential Government posture which boils down to this: Tax-

payers are dishonest wealthy individuals and, *ipsi dixit*, there is no reason to be concerned about the exactitude of evidence or deficiencies in the application of federal law resulting in conflicts among the several Circuit Courts of Appeal. The implicit argument of the Government is merely a rhetorical construct inviting the Court to conclude that taxpayers are bad people.

Even if it were true that Petitioners or any other citizens petitioning this Court were deficient in every character trait American society deems laudable, the predicate of our free society includes the principle that the right to govern includes the responsibility to do so fairly. One of the intrinsic badges of fairness within the litigation process requires the Government to establish its entitlement to taxes in law and fact. *Helvering* v. *Tex-Penn Oil Company*, 300 U.S. 481, 57 S.Ct. 569, 81 L.Ed. 775 (1937). In the instant case the Government failed to carry that burden.

1. The essential position of Petitioners rests upon three cardinal points which may be stated briefly. Firstly, District Judge Gus J. Solomon's Opinion[1] constituted Findings of Fact and Conclusions of Law. On May 20, 1981 Judge Solomon, after he had published his Opinion, stated on the record:

> ". . . But I am equally surprised that for five years nobody ever called my attention to the error, that grievous error that I made on Pages 60, 61, 62 in which I discussed various items . . . . Well, I forgot a couple of pages. Starting in from 57, 58, 59, 60 and 61, the major portion of my opinion, no one ever told me until today that all of this was irrelevant to any issue that was properly before me. . . . "I'm surprised that I spent the major portion of my opinion on matters that were never admitted into evidence." 5/20/81 RT 69-70, 75, CR 767.

The findings incorporated within the Opinion at the pages cited constitute all of the factual basis for the judgment against Petitioners and appear in the Opinion under the heading, "C. The Evidence of Tax Liability."[2] Included therein were recita-

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[1] *United States* v. *Stonehill*, 420 F.Supp. 46 (C.D. Cal. 1976).

[2] *Ibid.* at 57.

tions of problems in finding taxpayers' opening assets; the finding that taxpayers received kickbacks and unreported dividends and interest from investments; the finding that certain corporate assets belonged to the taxpayers personally and that Swiss bank accounts belonged to taxpayers and the holding that the Government was entitled to judgment against taxpayers for tax deficiencies.

The legal consequences of Judge Solomon's confession of error were ignored by the courts below, but, nevertheless, struck down the factual matrix upon which the Ninth Circuit constructed its decision in the case. It is submitted that no other circuit in the United States would fail to inquire into such a remarkable circumstance and address the matter in its opinion. The Ninth Circuit did, however, note that the District Judge had considered matters not in evidence.[3]

Secondly, there never was evidence in the record on the issue of tax liability. The judgment is devoid of any factual basis. The case-in-chief evidence for the Government consisted of two Certificates of Jeopardy Assessment. Before these documents were filed, the Government had conceded error and admitted each was more than 50 percent in error. This remarkable event resulted from the acknowledgment by the Government that it had not given taxpayers consideration of the effect of Philippine community property laws.[4] Once that concession of error was made, the entire factual accuracy of the certificates of assessment was destroyed. Where the tax is incorrect, the interest and penalty assessments are also incorrect. Thus, the Government put itself into the unique and precarious position of possessing inaccurate documents, introducing them as

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[3] *United States* v. *Stonehill*, 702 F.2d 1288, 1295, footnote 10.

[4] *Every* calculation in the abondoned multi-year net worth computation, on which the assessments were based, was destroyed by this singular, massive error, and the tax agent admitted it. "No, it won't come to 50 percent. It will be different." 4/25/75 RT 326. It is probable that the Government's refusal to introduce the underlying computation was to cover the enormity of this flaw and to seek refuge under the presumption of correctness.

evidence and being bound by their total lack of probative value. This surely represents a matter of first impression because the District Court and the Ninth Circuit approved the procedure.

The underlying rulings in the courts below place them in irreconcilable conflict with decisions of the Court and other circuit courts of appeal. In *United States* v. *Janis*, 428 U.S. 433, 96 S.Ct. 3021, 49 L.Ed. 2d 1046 (1976), this Court held that an income tax liability assessment shown to be naked and without any rational foundation is arbitrary and erroneous. 428 U.S. at 442. The Ninth Circuit's decision falls within the ambit of the *Janis* declaration.

When the Government introduced admittedly erroneous certificates of assessment the trial court extended to them presumptions of correctness. In fact, that court extended presumptions of correctness to matters not contained within the four corners of the certificates:

> "In the assessment, the Commissioner determined that the money [corporate funds] belonged to the taxpayers personally and that it was from current income. His determinations are presumed to be correct. . . ." *Stonehill*, 420 F.Supp. at 61.

Petitioners do not know upon what facts, or how such facts came before the Court or why the District Court made such a determination. There is no evidence supporting that finding of fact and conclusion of law. The Ninth Circuit approved the determination of the District Court.

The District Court cited 9 Mertens, *Law of Federal Income Taxation*, § 49.218 (1976) as stating the correct rule in tax collection cases. In part that rule states: ". . . if the taxpayer is successful in proving by a fair preponderance of the evidence that the assessment is erroneous, the burden shifts to the Government to prove whether any deficiency exists and, if so, in what amount." This view is amplified in the Second Circuit's decision in *United States* v. *Lease*, 346 F.2d 696, 701 (1965), where the Court held that a taxpayer defending a collection action had the burden of proving by a preponderance of the

evidence that the assessment is incorrect. When that burden is carried, "the presumption of correctness of the computation by the Commissioner *and the assessment with respect to that item disappears.*" (Emphasis added.) In *Bar L. Ranch, Inc.* v. *Phinney*, 426 F.2d 995 (5th Cir., 1970), the Court adopted the rule, "that a taxpayer defending a collection suit need only show that the Government's assessment was arbitrary and that the burden is then on the Government to show whether a deficiency exists and, if so, in what amount." The view expressed by Mertens, *op.cit.*, is believed to correctly state the majority rule among the circuit courts of appeal. See, *Hoffman* v. *Commissioner*, 298 F.2d 784 (3d Cir. 1962) and *Foster* v. *Commissioner*, 391 F.2d 727 (4th Cir. 1968).

By holding that admittedly factually erroneous certificates of assessment were entitled to a presumption of correctness, the court below ran afoul of the correct rule cited in the District Court. The burden on the taxpayers is to show that the assessment is erroneous. Where that is admitted by the Government, what else is there for the taxpayers to do? The conflict is magnified by the Ninth Circuit's view that it might extend the presumption to matters outside the record evidence, where under Second Circuit's view in *Lease*, *supra*, the presumption of correctness and the assessment with respect to that item "disappears." 346 F.2d at 701. Where the Second Circuit terminated the presumption upon a showing of incorrectness, the Ninth Circuit extended it to "parts" outside the record. 702 F.2d at 1295. The Ninth Circuit repudiated *sub silentio* in *Stonehill* its prior decision in *Clark* v. *Commissioner*, 266 F.2d 698, 706 (1959), which held, where shown to be inaccurate, a deficiency notice was not entitled to a presumption of correctness and the prior presumption *disappears:* "[t]he Tax Court's determination must then rest on all of the evidence introduced and its ultimate determination must find support in credible evidence."

2. The Government's Memorandum in Opposition contains assertions not justified by the record. The first literary paragraph (MO.1; emphasis added) asserts, "The decision below is

correct, *does not conflict with that of any other circuit*, and does not warrant review by this Court." The Government filed a Reply Brief on the Burden of Proof in Civil Action 65-127-GS, in the United States District Court for the Central District of California, which is a part of this record, representing to that Court:

> "The case that the taxpayers cite to support their contention is *United States* v. *Ball*, 326 F.2d 898 (C.A. 4, 1964). We will show in our argument here that (1) the legal premise of the *Ball* case is in conflict with the decisions of the Ninth Circuit . . . ." (Brief, at 4).

Notwithstanding the conflicts between this Court's decisions and those of other circuits demontrated above, the lead paragraph in the Government's brief is an astounding conflict with its prior representations to a United States District Court.

The personal assault on taxpayers includes the Government's statement, "Resolution was complicated by the absence of documents and witnesses, including petitioners, who appeared neither for scheduled depositions nor for trial."[5] (Mo. at 3). Petitioner Brooks did give a deposition in this case. By stipulation made on April 9, 1965 in the United States District Court for the Southern District of California, No. 65-127-HW, paragraph 8(a), the Government agreed:

> "In the event that the defendants Lourdes B. Stonehill, Robert P. Brooks and Pacita C. Brooks, or any of them, enter their appearance in the within action, such appearance shall not require the said Lourdes B. Stonehill, Robert P. Brooks and Pacita C. Brooks, or any of them, to

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[5] It would be interesting in result for this Court to call upon the Government to support the allegation that Petitioners failed to appear for a scheduled deposition. A diligent search suggests no such event ever occurred. Further, it is uncontroverted that the Government, not the taxpayers, possessed and controlled the thirty-five truckloads of documents seized by Philippine authorities, or at least had access to those records when taxpayers had none. The Government's selective copying of records, not taxpayer obstinance, must bear the responsibility for this complaint.

> physically enter the United States for the purpose of defending this action or for any other purpose connected with this suit, or the related suits pending in the District of Hawaii and the Northern District of California."

For the Government to complain, where litigants did precisely what the Government agreed with them would be proper, smacks of more than mere irresponsibility.

The Government would lead this Court to believe its factual assertion on pages 2 and 3 of its Memorandum in Opposition were worthy of credit. They are not for two primary reasons: The District Judge recanted his reliance on issues not properly before him—specifying pages 57 through 61 of his published Opinion, 420 F.Supp. at 57 through 61, and at trial on May 28, 1975 declared:

> "THE COURT: ". . . you [BIGGINS] were given the privilege of proving the correct amount of the deficiency. You elected to put in the deficiency and rely on the presumption and require the defendants to go forward with the evidence. *I permitted you to put in some evidence through Mr. Ragland solely for the purpose of showing fraud . . . .*" (RT 170-171; emphasis added).

Such is the state of the record underlying the decision below. Findings were made on the basis of matters not in evidence, legal doctrines were bent beyond recognition in their application to admittedly erroneous documents to give them support and a degree of imprecision appears which would not be tolerated in other circuit court of appeals. The failure of the Government to confront the issues and to deal candidly with them should not prevent inquiry into the fundamental problems which emanate from the decision below and impact upon the entire community of American taxpayers. The failure of the Government to place in evidence factual bases for its claims produced the result that, "[t]here was no 'suitable opportunity through evidence and argument * * * to challenge the result.'" *Ohio Bell Telephone Co.* v. *Public Utilities Commission*, 301 U.S. 292, 57 S.Ct. 724, 730, 81 L.Ed. ____ (1937), quoting *West Ohio Gas Co.* v. *Public Utilities Commission (No. 1)*, 294 U.S. 63, 70, 55 S.Ct. 316, 320, 79 L.Ed. 761.

Without evidence of income for each tax year, how does the Government assert a claim or the court award a judgement? The trial court *guessed* by working tax rate tables backwards to derive income for the several years in question. A fundamental problem, putting taxpayers' personal interests aside, is that the Ninth Circuit had no meaningful basis upon which to make an intelligent estimate of the correctness of the procedures used, the results obtained or to weigh the merit of Petitioners' objections. As Mr. Justice Cardozo observed in an analogous circumstance, "To put the problem more concretely: How is it possible for the appellate court to review the law and facts and intelligently decide that the findings of the Commission were supported by evidence when the evidence that it approved was unknown and unknowable?" *Ohio Bell, supra*, 57 S.Ct. at 730.

Taxpayers may owe additional income taxes or they may not. There is no evidentiary basis to say that they do own some particularized amount. Despite the most cogent demonstratrion that all of its substantive premises and conclusions in this case are infected by error and are simply wrong, the Government seeks to ignore the issues and assert that the case is not worthy of review. Congress did not intend the results demonstrated in the record; no other circuit would permit it, and the result clashes with *United States* v. *Janis, supra*. The length of this litigation or the possibility of further delay is inadequate reason for the Government to avoid confronting important issues and assisting this Court in understanding the record below. Again, Mr. Justice Cardozo touched the crux of the issue when he wrote, "There can be no compromise on the footing of convenience of expediency, or because of a natural desire to be rid of harassing delay, when that minimal [fair and open hearing] requirement has been neglected or ignored." *Ohio Bell, supra*, 57 S.Ct. at 731.

CONCLUSION

This Court should grant Certiorari and set the case for argument to resolve the conflict among the Circuits on the

important question of whether a "presumption" of correctness attaches to jeopardy assessments when serious and pervasive errors in the Government's computation stand admitted on the record and the Government offers no evidence of specific taxable income. In the alternative, this Court should summarily vacate the decision below and remand the case for further consideration of the admission of error by Judge Solomon and for further consideration of the applicability of this Court's decision in *Janis, supra*. To allow the judgment of the Ninth Circuit in this case to stand would inflict not only a serious injustice, but would create a precedent permitting the Government to collect millions of dollars in taxes based on the "presumptive" correctness of *ex parte* calculations not in evidence.

Respectfully submitted,

RIDGWAY K. FOLEY, JR.

FEBRUARY 1984

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1983

UNITED STATES OF AMERICA,

Respondent,

v.

HARRY S. STONEHILL,
ROBERT P. BROOKS
LOURDES BLANCO STONEHILL,
PACITA C. BROOKS, et al

Petitioners.

CERTIFICATE OF SERVICE OF REPLY MEMORANDUM
IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI
BY LOURDES BLANCO STONEHILL AND PACITA C. BROOKS
AND BY HARRY S. STONEHILL AND ROBERT P. BROOKS
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

I, BERT B. RAND, a member of the Bar of the Supreme Court of the United States, and counsel of record for Petitioners Lourdes Blanco Stonehill and Pacita C. Brooks, and for and on behalf of RIDGWAY K. FOLEY, JR., P.C., a member of the Bar of the Supreme Court of the United States, and counsel of record for the Petitioners Harry S. Stonehill and Robert P. Brooks, hereby certify pursuant to Rule 28.5, Supreme Court Rules, that I served three certified true copies of each of the Reply Memorandum in Support of the Petition for Writ of Certiorari on behalf of the above named Petitioners, on the 14th day of February, 1984 by depositing said copies in the United States Post Office, Washington, D.C., with first-class postage prepaid,

to the following persons at the following last known addresses thereof, these persons being counsel for all parties represented in the proceedings below:

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In addition, pursuant to Rule 28.4, Supreme Court Rules, I also served the Solicitor General by depositing three certified true copies of each of the aforementioned Reply Memorandum on behalf of the aforenamed Petitioners, in the United States Post Office, Washington, D.C., on the 14th day of February, 1984, duly addressed to:

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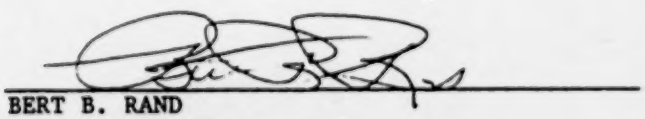

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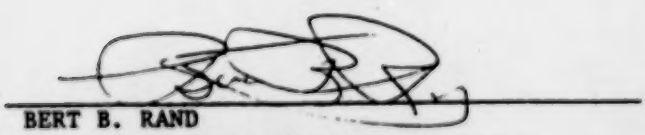

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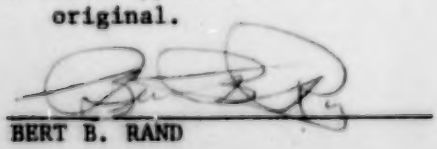

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